MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The Fed Gives Rates An Upward Nudge

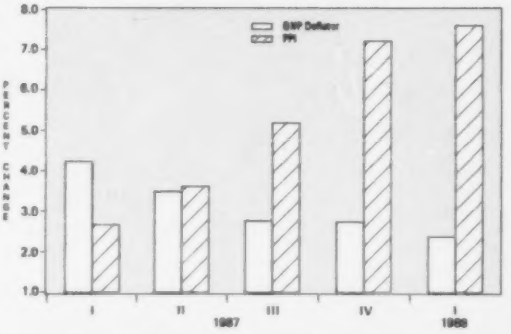
With signs of economic vigor seemingly in abundance throughout a good chunk of the economy, the financial markets have set aside their fears of a global business slump and are instead focusing on the next logical question. This is determining at what point today's apparently robust business conditions will spill over into rising inflation rates and tighter monetary policies. To some observers, this point has already been reached; they view the upturn in industrial commodities prices and industry operating rates, not to mention the recent rise in interest rates as the forerunners of a pronounced acceleration in the rate of inflation and a progressive tightening of the credit reins.

But despite these concerns, there are several bright spots in what appears to be an otherwise gloomy picture. The combination of a subdued rise in producer prices in April and a firming of the dollar's external value on the heels of a sharp narrowing of the merchandise trade deficit in March may have dampened the inflation threat for now. These developments should diminish the likelihood of another turn of the monetary screws anytime soon, brightening the prospects for at least a brief period of stable short-term interest rates.

The first piece of good news was the producer price report. According to the Labor Department, producer prices rose by 0.4 percent in April month-over-month, slower than the 0.6 percent rise posted in March, and not far from the monthly average registered during the entire first quarter. Perhaps more important, the modest April rise largely reflected an upturn in heating oil and natural gas prices. When the volatile food and energy components of the index are excluded, April's producer prices increased by a mere 0.1 percent, the smallest increase since last fall. Not only did this result provide some degree of solace to the bond market, but it must have also cheered Fed policymakers who have found themselves increasingly taking their policy cues from the reactions of the fixed-income market to the endless stream of statistics.

The trend in producer prices was not completely benign, however. Prices paid by manufacturers for such intermediate goods as chemicals and paper products rose at a much faster clip than did prices for finished goods. In fact, the 0.8 percent monthly increase in intermediate goods prices in April was the fastest monthly rise so far this year.

GNP DEFLATOR VS. PRODUCER PRICE INDEX FOR INTERMEDIATE GOODS EXCLUDING FOOD AND ENERGY (QUARTERLY PERCENT CHANGES AT ANNUAL RATES)



What is more, with energy prices leading the way, prices of crude goods increased sharply in April—suggesting that while inflation may seem modest at the moment, there is quite a bit of it in the "pipeline"—presumably just waiting to materialize in the months ahead.

Not All The News Is Bad

However, the acceleration of so-called "pipeline" inflation, which has been underway for over a year, is hardly convincing evidence that an intensification of economy-wide price pressures is at hand, especially if you consider recent trends in the GNP deflator, or price index. This is the broadest, and perhaps most accurate gauge of overall price pressures, reflecting as it does current consumption patterns, rather than trends in the prices of a fixed basket of goods which does not change from one period to the next.

As shown in the chart, the rate of price rise as measured by this index has slowed for four quarters in a row, despite the ongoing upturn in "pipeline" inflation. This means that, while the prices of some goods may be rising faster than before, they are largely being shunned; the goods people are actually purchasing are those whose prices are rising more slowly (Financial Digest—May 9, 1988).

Manufacturers Hanover Economics Department 17/270

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Big Improvement On The Trade Front

The second piece of good news was the pronounced narrowing of the merchandise trade deficit in March. Whereas a sizable widening of the monthly trade imbalance in February to nearly $14 billion sparked a renewed round of dollar selling, and heightened fears of higher import prices and inflation rates, the reported narrowing of the trade deficit in March, to $9.75 billion, has had the opposite effect—bolstering the dollar's external value and diminishing the likelihood of an import price surge. So far, so good.

In today's jittery financial markets, however, every silver lining must have a cloud, and even the long-sought improvement in the trade deficit had one. With exports surging by a sharp 23 percent in March month-over-month, to a record of nearly $29 billion, helping to lift capacity utilization rates to their highest level since 1980, the inflation threat seemed to mount, not diminish. As a result, the bond market reacted negatively to the good trade news, sending prices lower and yields significantly higher.

But, although capacity utilization rates have

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/4/88)	181,246	+ 1,205	+ 11,069
New York City (5/11/88)	37,586	– 310	+ 1,155
Commercial Paper (5/11/88)	410,917	+ 706	+ 56,416

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/4/88)	301,560	+ 3,642	+10,497
New York City (5/11/88)	58,381	– 563	– 3,340

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/4/88)	892,994	+11,668	+44,294
New York City (5/11/88)	175,061	– 6,054	–31,504

Financial Markets

	Friday 5/20/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.41%	+ .06	+ .71
180-Day Bills†	6.91	+ .20	+ .52
Longest Bills†	7.42	+ .19	+ .38
Recent Issues:			
7⅝s 4/30/90	8.01	+ .16	
7⅞s 3/31/92	8.49	+ .18	
9s 5/15/98	9.39	+ .41	
9⅛s 5/15/18	9.31	+ .21	
Municipals:			
Bond Buyer—20 Bond Index* (5/19/88)	7.97%	+ .12	– .34
Blue List Total ($ Million)	$1,433	+ $ 89	– $377
30-Day Visible Supply ($ Million)	$2,872	+ $1,001	+ $150
Total	$4,305	+ $1,090	– $227
Corporates:			
Moody's Aa Composite (5/19/88)	10.18%	+ .13	+ .38
30-Day Visible Supply ($ Million)	$3,576	– $ 984	+ $183
Stocks:			
Dow-Jones Averages:			
Industrials	1,952.59	– 37.96	–290.61
Transportation	796.59	– 25.84	–137.22
Utilities	168.74	+ .35	– 26.27
65 Stocks	725.25	– 14.39	–114.31
N.Y.S.E. Composite Index	143.30	– 2.00	– 15.75
N.Y.S.E. Avg. Daily Vol. for Week (000's)	157,000	+ 3,754	–14,542

*34% Taxable equivalent 12.08%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/20/88	Week Ago
Overnight	6.88%	6.88%
1 month	7.19	7.13
3 month	7.44	7.38
6 month	7.63	7.56
1 year	8.13	8.00

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/20/88)	Currency Per U.S. $	Week Ago
Belgium	35.34	35.17
Canada	1.2422	1.2331
France	5.7610	5.6970
Germany	1.7035	1.6815
Italy	1263.50	1250.50
Japan	124.94	124.60
Mexico	2273.00	2273.00
Netherlands	1.9065	1.8845
South Korea	734.30	735.80
Switzerland	1.4203	1.3987
Taiwan	28.62	28.61
U.K.*	1.8637	1.8895

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (5/20/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+1.0%	–7.3%

been trending higher, and such industries as paper and steel are operating at close to full capacity, the near-term price threat again appears exaggerated. For one thing, industry's overall operating rate is still well below the peak level reached in the earlier business expansions. In April, capacity utilization stood at 82.7 percent which is still some four percentage points below the peak operating rate of the late 1970s. For another, large chunks of idle capacity still exist in such industries as automobiles, electrical and non-electrical machinery. This means that additional large production gains can still be accommodated without triggering substantially higher prices.

While the Federal Reserve has nudged interest rates slightly higher in order to pre-empt an intensification of inflation expectations, whether there will be additional firming moves anytime soon is an unanswered question. One Fed governor has suggested there may not be—at least not yet. In light of both the producer price and trade balance news, the urgency of such a move would appear to have diminished. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/18/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	233.026	– 1.541	+10.765
Loans to Depository Inst.	2.270	+ .190	+ 1.379
Float	.779	– .056	– .237
Total Reserve Bank Credit	251.300	– 2.388	+11.642
Treasury Deposits with Federal Reserve Banks	5.996	– 7.156	– 8.944
Currency in Circulation	230.569	+ .497	+18.573
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	231.623	+ 1.726	+48.630
	5/18/88		
Member Bank Reserves:			
Total Reserves Held	58.699	– .926	+ 1.422
Excess (Deficiency)	.961	– .097	– .101
Net Free Reserves	.584	– .037	+ .076
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**‡ % Change Since Year Ago**
M1 (5/9/88)	769.1	+ 5.4	+ 3.2
M2 (5/9/88)	3,000.9	+ 8.1	+ 5.1
M3 (5/9/88)	3,773.7	+ 7.2	+ 5.9
Domestic Nonfinancial Debt (4th Q'87)	8,361.5	+ 10.2	+ 10.0

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 5/20/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.25%	6.57%	6.93%
* Federal Agencies	6.95	7.05	7.20
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.20	7.20	7.20
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.23	7.55	7.95

‡ Finance Company Paper—Prime

5- 14 days	6.75%
15- 29 days	6.95
30- 59 days	7.00
60- 89 days	7.15
90-179 days	7.15
180-239 days	7.00
240-270 days	7.00

‡* Bankers' Acceptances

Jun.	7.00%
Jul.	7.08
Aug.	7.13
Sep.	7.18
Oct.	7.20
Nov.	7.28

‡ Industrial Paper—Prime

30- 89 days	7.08%
90-120 days	7.15

† Federal Funds Effective Rate 7.20%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

		Latest Period or End of Period	Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	Q'88	$ 4,661	$ 4,607	$ 4,378
Gross National Product (1982 Dollars)*	Q'88	$ 3,903	$ 3,881	$ 3,772
Percent Change, Annual Rate	Q'88	2.3	4.8	4.4
Change in Consumer Prices*	'88n	4.8%	6.0%	4.8%
Change in MH Cost of Living Index	'88n	9.6%	8.4%	7.2%
Change in Producer Prices*	Apr '88n	4.8%	7.2%	7.2%
Civilian Employment (Thousands of Persons) †	Apr '88	114,713	114,103	111,806
Unemployment as % of Civilian Labor Force †	Apr '88	5.4%	5.6%	6.3%
Personal Income*	Mar '88	$ 3,924	$ 3,895	$ 3,683
Leading Indicators Composite Index (1967=100) †	Mar '88	193.3	191.7	187.6
Industrial Production Index (1977=100) †	Apr '88n	135.6	134.7r	127.4
Net Change in Consumer Installment Credit †	Mar '88	$ 4.46	$ 5.04	$ 1.84
U.S. Merchandise Trade Balance	Mar '88n	–$ 9.75	–$ 13.83	–$ 12.92
Plant and Equipment Expenditures*	2nd Q'88	$427.09(a)	$422.75(a)	$377.65
Private Housing Starts (Thousands of Units)*	Apr '88n	1,561	1,554r	1,635
New Construction Expenditures*	Mar '88	$ 401.8	$ 396.0	$ 388.3
Total Business Inventories †	Mar '88n	$ 720.0	$ 717.9r	$ 668.7
Total Business Sales †	Mar '88n	$ 479.5	$ 470.7r	$ 444.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

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New York, N.Y.
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SRI ACQUISITIONS
CONGRESSIONAL INFORMATION
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SUITE 800
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